

**Letter of Findings Number: 08-0487
Sales and Use Tax
For Tax Year 2005**

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ISSUES

I. Sales and Use Tax – Rental Exemption.

Authority: IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-3-5; IC § 6-2.5-5-8; IC § 6-8.1-5-1; [45 IAC 2.2-3-4](#); [45 IAC 2.2-5-15](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't. of Revenue v. Interstate Warehousing, 783 N.E.2d 248, 250 (Ind. 2003).

Taxpayer protests the denial of its eligibility for the rental exemption.

II. Tax Administration - Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana single-member LLC formed on September 13, 2002, for the purpose of leasing and/or chartering aircraft. The LLC owned several aircraft over time, one of which was for personal use and the others for lease. Taxpayer is properly registered as an Indiana retail merchant. On August 25, 2005, Taxpayer purchased a 1969 aircraft, referred to as MU-2, for \$350,000 and was properly registered with the FAA and Indiana.

After a review of the Taxpayer's sales reporting for 2008, the Indiana Department of Revenue ("Department") determined that Taxpayer no longer qualified for the rental exemption and issued assessments for use tax based on the purchase price of the aircraft, as well as interest and a ten percent negligence penalty. Taxpayer protested this determination and the assessments. A hearing was held and this Letter of Findings ensues. Further facts will be supplied as required.

I. Sales and Use Tax – Rental Exemption.

DISCUSSION

Taxpayer protests the Department's determination that it did not qualify for the Indiana use tax rental and leasing exemption. Taxpayer did not pay sales tax at the time it purchased the aircraft, nor did Taxpayer pay use tax when it registered its aircraft in Indiana. Taxpayer has been paying sales tax on its intermittent lease stream.

The Department notes that all tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(b),(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Indiana imposes a use tax on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction. IC § 6-2.5-3-2; [45 IAC 2.2-3-4](#). IC § 6-2.5-3-4(a)(2) allows for a use tax exemption for property that is acquired in a transaction that is exempt from sales tax under IC § 6-2.5-5, and the property is being stored, used, or consumed for the purpose for which it was exempted.

The rental and lease exemption is found at [IC 6-2.5-5-8\(b\)](#) which states that,

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of his business without changing the form of the property.

The rental exemption set out in IC § 6-2.5-5-8 is further explained in [45 IAC 2.2-5-15](#), which states:

(a) The state gross retail tax shall not apply to sales of any tangible personal property to a purchaser who purchases the same for the purpose of reselling, renting or leasing, in the regular course of the purchaser's business, such tangible personal property in the form in which it is sold to such purchaser.

(b) General rule. Sales of tangible personal property for resale, renting or leasing are exempt from tax if all of the following conditions are satisfied:

(1) The tangible personal property is sold to a purchaser who purchases this property to resell, rent or lease it;

(2) The purchaser is occupationally engaged in reselling, renting or leasing such property in the regular course of his business; and

(3) The property is resold, rented or leased in the same form in which it was purchased.

(c) Application of general rule.

(1) The tangible personal property must be sold to a purchaser who makes the purchase with the intention of reselling, renting or leasing the property. This exemption does not apply to purchasers who intend to consume or use the property or add value to the property through the rendition of services or performance

of work with respect to such property.

(2) The purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. Occasional sales and sales by servicemen in the course of rendering services shall be conclusive evidence that the purchaser is not occupationally engaged in reselling the purchased property in the regular course of his business.

(3) The property must be resold, rented or leased in the same form in which it was purchased.

When a taxpayer claims it is entitled to a tax exemption, it bears the burden of proving that the terms of the exemption have been met. *Indiana Dep't. of Revenue v. Interstate Warehousing*, 783 N.E.2d 248, 250 (Ind. 2003). The Department will strictly construe the exemption statutes against the taxpayer claiming the exemption. *Id.*

Taxpayer stated that it was in the business of renting the aircraft and therefore qualified for the rental exemption on the airplane. This exemption requires, therefore, compliance with three elements. One of these requirements is that Taxpayer must be engaged in the reselling, renting, or leasing of such property in its regular course of business.

The aircraft in question was purchased from another, unrelated, limited liability company, then leased back to that same company ("Lessee"). The lease agreement, dated September 1, 2005, states that Lessee will pay a \$3,000 flat fee per month for one year at which time the contract would be re-evaluated (this replaced a July 2005 agreement that stated the rate at \$2,900 per month). Lessee was responsible for the insuring the aircraft and all hourly direct costs. Taxpayer did not provide flight logs to document the actual use of the aircraft. Taxpayer did remit sales tax on monthly sales of approximately \$3,000 per month from July 2005 through April 2006. Taxpayer presented a deposit income/report (as well as an expense report) for the time period beginning December 1, 2002, and ending December 1, 2007. The sales reflected on this report mostly comport with the sales reported to the Department for those periods.

Subsequently, Taxpayer continued to report sales and remit sales tax, but on much lower sales. Taxpayer states, in a letter to the Department dated March 5, 2008, that after eight months Lessee defaulted. Taxpayer sought new clients to no avail and explains that the industry has experienced a severe downturn in recent years. Taxpayer decided to resume his training as a pilot in order to provide his services along with the lease of the aircraft as a charter service. Taxpayer stated he used the aircraft for this training purpose. Taxpayer explained that it was also not good for the aircraft to be stored without use. Taxpayer's income report shows that the aircraft was used for a handful of hours a month in August 2006 and then from May through October 2007. Taxpayer has more recently had its aircraft for sale.

[IC 6-2.5-3-4](#) states:

(a) The storage, use, and consumption of tangible personal property in Indiana is exempt from the use tax if:

(1) the property was acquired in a retail transaction in Indiana and the state gross retail tax has been paid on the acquisition of that property; or

(2) the property was acquired in a transaction that is wholly or partially exempt from the state gross retail tax under any part of [IC 6-2.5-5](#), except [IC 6-2.5-5-24](#)(b), and the property is being used, stored, or consumed for the purpose for which it was exempted.

(b) If a person issues a state gross retail or use tax exemption certificate for the acquisition of tangible personal property and subsequently uses, stores, or consumes that property for a nonexempt purpose, then the person shall pay the use tax.

(Emphasis added).

In late 2005 and through mid-2006, Taxpayer was leasing its aircraft and therefore comporting with the requirements for exemption from sales and use tax. However, Taxpayer has not met the burden imposed by IC § 6-8.1-5-1(c) to show that in 2007 and 2008 it was still in the business of renting and leasing the subject aircraft. Since Taxpayer is no longer using the aircraft for the purpose for which it was exempted, Taxpayer is, therefore, obligated to pay use tax on its use and/or storage of the aircraft in Indiana. IC § 6-2.5-3-4(a)(2).

Taxpayer, therefore, owes use tax calculated on the \$350,000 purchase price of the aircraft.

FINDING

Taxpayer's protest of the assessment of use tax on the purchase price of the aircraft is respectfully denied.

II. Tax Administration - Negligence Penalty.

DISCUSSION

The Department issued proposed assessments and the ten percent negligence penalty for the tax year in question. Taxpayer protests the imposition of penalty. The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

...

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

...

the person is subject to a penalty.

The Department refers to [45 IAC 15-11-2](#)(b), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or

diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

[45 IAC 15-11-2](#)(c) provides in pertinent part:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, Taxpayer's initial use of the aircraft comported with the requirements of the rental exemption. Its failure to continue such exempt use was due to reasonable cause and therefore did not incur a deficiency due to negligence under [45 IAC 15-11-2](#)(b), and so is not subject to a penalty under IC § 6-8.1-10-2.1(a).

FINDING

Taxpayer's protest of the negligence penalty is sustained.

CONCLUSION

Taxpayer's protest of the assessment of use tax is respectfully denied, but Taxpayer's protest of the assessment of negligence penalty is sustained.

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